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Centre for Development and Environment (CDE)

“The least developed countries remain de facto excluded from tax information exchange”

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Switzerland is one of the world’s leading hubs for commodity trading – a business that is anything but transparent. A research project is currently investigating ways of curbing illicit financial flows from resource-rich developing countries. Such flows not only violate national or international laws but often also inhibit sustainable development. Transparency and exchange of information in tax matters are possible levers to improve the situation. But where does Switzerland stand today, and what measures are needed in the future? CDE scientist Irene Musselli outlines the latest findings from the project's legal research.

Irene Musselli. Photo: Gaby Allheilig

Interview: Gaby Allheilig

Revelations from the Paradise Papers suggest that companies and agents based in Switzerland are involved in opaque transactions and potentially corrupt commodity trading. You have examined where Switzerland stands with regard to transparency and exchange of tax information. What is your main conclusion?

Since these revelations, Switzerland has committed to improving tax and trade transparency and to curbing illicit financial flows linked to commodity trading. However, a look at how this is implemented in practice shows that the Swiss exchange-of-information network remains skewed towards higher-income countries. The least developed countries remain *de facto* largely excluded from tax information exchange.

"Switzerland has made dramatic advances"

So the situation can be summarized as "white money from rich countries, black money from poor countries"?

The answer requires some nuances. There are various exchange procedures, various degrees of commitment, and various levels of implementation. For example, implementation can happen on paper or in practice. Implementation on paper focuses on the Swiss legal framework for information exchange, and its progress is closely linked with political commitments to further tax transparency. In these respects, Switzerland has made dramatic advances and is now aligned with international standards. It has, in principle, opened up to all interested countries that meet standard requirements.

Then what explains the gap between theory and practice?

The main problem is poor countries' limited capacity to implement international information exchange standards. Receiving countries must have in place adequate laws, operational procedures, and IT solutions to protect the confidentiality of tax information. To qualify as a potential exchange partner under the automatic exchange procedure, a country must undergo a preliminary assessment regarding confidentiality and data safeguards at both the legal and the operational level. In addition, Switzerland exchanges tax information exclusively on a reciprocal basis. This means that Switzerland's exchange partners must additionally have in place adequate laws and regulations concerning the availability, the gathering, and the transmission of information.

"Switzerland could temporarily lift reciprocity requirements"

What could Switzerland do to include poor countries?

Switzerland could possibly ease some procedural requirements that limit the use of exchange of information mechanisms in poor countries. There are opportunities to move forward, pragmatically, through minor changes to administrative practices in a number of respects.

Can you give an example?

Switzerland could temporarily lift reciprocity requirements for a few selected low-income countries during a transitional phase-in period. This would open up the possibility to exchange information with countries that do not have the administrative capacity to gather and transmit information on their side. Such non-reciprocal exchange could still be conditioned on developing countries having in place adequate safeguards to ensure confidentiality and data protection.

Wouldn’t that undermine taxpayers’ rights?

A relaxation of reciprocity would not imply any erosion of taxpayers’ privacy rights. Note that Switzerland already supplies information on a de facto non-reciprocal basis, as the information requests met by Switzerland far exceed the requests it submits to other countries.

“Switzerland could deepen its technical cooperation in this area”

And what about other possibilities of involving poor countries in the exchange of tax information?

Switzerland could deepen its technical cooperation in this area by testing innovative exchange-of-information practices as a voluntary partner in pilot projects. The focus here would be on peer-to-peer, transactional knowledge transfer, including by temporarily loaning out staff to tax administrations in developing countries. The approach could be modular, with procedures phased in gradually. In Switzerland, this would involve increased interaction and coordination between the Federal Tax Administration, the State Secretariat for Economic Affairs, the State Secretariat for International Financial Matters, and the Swiss Agency for Development and Cooperation.

In your report, you also suggest unilateral routes for low-income countries.

Indeed, this is something that Switzerland could reconsider. It would mean that exchange would be based on a domestic law provision. This could provide a legal basis for exchange of information with poor countries in the medium term, in the context of pilot technical-assistance projects aimed at preparing the ground for full-fledged exchange of information. Operationalized by memoranda of understanding rather than bilateral exchange treaties, the domestic provision could enable a tailor-made approach to implementation that goes beyond one-size-fits-all solutions.

“Tax transparency is not a panacea – at least not for all ills”

All these measures cost a lot of money – be it in Switzerland or in developing countries…

Exchange of information in tax matters is a costly endeavour, particularly in terms of the investment needed to set up the required infrastructure in countries facing structural gaps and hurdles. And tax transparency is not a panacea – at least not for all ills. For example, it is a complex, indirect tool for tackling commodity trade mispricing. There is a certain risk that interventions in this regard could be short-lived and doomed to fail. On the other hand, they have the potential to yield lasting results and act as a catalyst or entry point for far-reaching, incremental tax system reforms in poor countries – especially if implemented in concert with domestic efforts to mobilize resources.

What are the alternatives?

Alternative measures and tools specifically geared to counter value manipulation in cross-border transactions include simplified transfer pricing methods and changes to the current international tax architecture. These measures should be considered in addition to tax transparency – and they need to be further researched.

CDE WORKING PAPER

Curbing Illicit Financial Flows in Commodity Trading: Tax Transparency

The 2030 Agenda calls for combating illicit financial flows in commodity trading. The aim is to enable resource-rich countries to secure their corresponding tax revenues. As a major commodity-trading hub, Switzerland has recently taken steps to expand its exchange of relevant data. In a working paper, CDE researchers Irene Musselli and Elisabeth Bürgi Bonanomi investigated how effective exchange of tax information is in counteracting mispricing in commodity trading and whether there are alternatives.

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THE PROJECT

Research partnership between Switzerland, Laos, and Ghana

The interdisciplinary research project on «Curbing illicit financial flows from resource-rich developing countries: Improving Natural Resource Governance to Finance Development» aims at improving knowledge of commodity trade-related IFFs as well as designing and promoting effective ways to address them from a scientific and policy perspective. The project is part of the r4d programme, funded by Swiss Agency for Development and Cooperation and the Swiss National Science Foundation.

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